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No. 84-679

In The Supreme Court
Of The
United States

October Term 1984

BATEMAN EICHLER, HILL RICHARDS, INCORPORATED,

Petitioner,

vs.

CARL F. BERNER, et al.,

Respondents.

On Petition For A Writ Of Certiorari
To The United States Court Of Appeals
For The Ninth Circuit

BRIEF IN OPPOSITION

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QUESTIONS PRESENTED

1. Is the defense of *in pari delicto* inappropriate as the sole basis for dismissal of a complaint in a private action under the federal securites laws, unless the alleged facts show that the investor is equally responsible for his injury?

2. Assuming that a broker or corporate insider has encouraged investors to purchase securities based upon a representation that the investors are being given "non-public" information and such information proves to be untrue and made with the degree of *scienter* for which there would be liablity under this Court's decision in *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976), are the duped investors ever *in pari delicto*?

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OPINIONS BELOW

For purposes of correcting the record, Appendix C referred to in the petition at page 2 is the Order of the United States District Court for the Northern District of California, not the Central District of California.

STATUTES AND REGULATIONS INVOLVED

Respondents dispute petitioner's contention that Section 16 of the Securities Act, 15 U.S.C § 77p, and Section 28(a) of the Securities Exchange Act, 15 U.S.C. § 78bb, affect the issue presented by the petition.

Respondents do not dispute petitioner's contention that Section 2 of the Insider Trading Sanctions Act may affect the issue presented by the petition but respectfully submit that its effect, if any, is to support the conclusion reached by the Ninth Circuit.

STATEMENT OF THE CASE

Petitioner's description of the respondents and their motives as set forth in the petition's statement of the case is colorful, but misleading in terms of the issue, if any, raised by the decision of the Ninth Circuit.

Respondents' complaint alleged that Bateman Eichler, Hill Richards, Incorporated, a broker-dealer, Charles P. Lazzaro, its registered representative, T.O.N.M. Oil & Gas Exploration Corporation, a public corporation, and Leslie L. Neadeau, it's president, engaged in a scheme to manipulate the price of T.O.N.M. stock commencing in November, 1979. (CR:1 at ¶¶ 16, 23). 1/ This

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1/ The CR references are to the Clerk's Record on Appeal, with the number referring to the district court docketing number. CR:1 is the Complaint.

scheme involved representations concerning the business prospects for T.O.N.M. and the relationship between Lazzaro and T.O.N.M. (CR:1 at ¶¶ 15-17, 19-22). The representations are alleged to have been made by the defendants with the intention of inducing purchases of T.O.N.M. stock for the purpose of creating an artificially high demand and price for T.O.N.M. stock. (CR:1 at ¶¶ 16, 29, 31, 34). The representations are alleged to be false (CR:1 at ¶ 30) or materially incomplete (CR:1 at ¶ 33). The defendants are alleged to have known the falsity of the representations. (CR:1 at ¶ 32). The plaintiffs are alleged to have purchased T.O.N.M. stock in reliance on defendants' misrepresentations and as a result of their unlawful scheme. (CR:1 at ¶¶ 15, 41a). Plaintiffs' purchases of T.O.N.M. stock were made through the mechanism of

the National Association of Securities Dealers over-the-counter system ("NASDAQ"), a national securites exchange. (CR:1 at ¶ 14). And, finally the scheme produced a substantial manipulation in the price of T.O.N.M. stock. (CR:1 at ¶ 14).

Thus, what respondents "admitted" in their complaint, what the Ninth Circuit focused upon in rendering its decision, 2/ but what the petitioner resolutely ignores in presenting the issue to this Court, is that respondents were used by petitioner, without their knowledge, in an effort by petitioner to manipulate the securities market.

Petitioner's characterization in its statement of the case of the Ninth Circuit's decision is equally misleading.

2/ See Opinion, App. A-2, A-3.

The Ninth Circuit's conclusion is simply stated:

> "We have concluded that the defense of in pari delicto is inappropriate as the sole basis for the dismissal of a complaint, in a private action under the federal securites laws, unless the alleged facts show that the investor is equally responsible for his injury."

Opinion, App. A-11.

SUMMARY OF ARGUMENT

It is respectfully submitted that the Ninth Circuit's decision is neither "sweeping" nor "stunning". It represents a logical extension of this Court's decisions recognizing a private right of action under the antifraud and market manipulation provisions of the federal securities laws [3] and limiting the use of common law defenses to defeat the

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3/ Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976).

usefulness of the private action to effectuate the policy underlying federal regulatory schemes. [4]

Any alleged conflict between the decision of the Ninth Circuit below and the decisions of the Third Circuit in Tarasi v. Pittsburg National Bank, 555 F.2d 1152 (3d Cir.), cert. denied, 434 U.S. 965 (1971), of the Fourth Circuit in Malamphy v. Real-Tex Enterprises, Inc., 527 F.2d 978 (4th Cir. 1975), of the Fifth Circuit in Ruehnert v. Texstar Corp., 412 F.2d 700 (5th Cir. 1969), and of the Eleventh Circuit in Silverberg v. Paine, Webber, Jackson & Curtis, Inc., 710 F.2d 678 (11th Cir. 1983), is reconcilable in light of this Court's holding in Ernst & Ernst requiring a plaintiff to

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4/ Perma Life Mufflers, Inc. v. International Parts Corp., 392 U.S. 134 (1968).

prove scienter in order to prevail under the antifraud provisions of the federal securities laws.

That the private right of action for federal securities law violations was implied by the courts rather than expressly provided by Congress as is the case for federal antitrust law violations is not a basis to distinguish this Court's holding in Perma Life. If anything, the federal courts' uniform determination that effective enforcement for the policy underlying the federal securities laws is so important that a private right of action should be inferred would seem to suggest that any hurdle to such an action must be carefully scrutinized.

Nor does the decision of the Ninth Circuit conflict with any expressed or implied policy of Section 16 and Section 28(a) of the Securities and Securities

Exchange Acts or of the recently adopted Insider Trading Sanctions Act. Sections 16 and 28(a) of their respective acts expand the rights and remedies of the defrauded investor rather than limit them as the application of defenses would do. And, reliance on the lack of private remedies under the Insider Trading Sanctions Act of 1984 (1984 U.S. Code Cong. & Ad. News (98 Stat.) 1264) for enforcing the ban on insider trading fails to address what respondents' complaint puts in issue. Respondents' complaint is not about insider trading. It is about a market manipulation scheme perpetrated by a broker-dealer and corporate insiders in violation of the antifraud provisions of the federal securities laws -- a scheme which used respondents and a scheme by which respondents, undoubtedly other

investors, and the integrity of the securities markets were injured.

Notwithstanding the national importance of the area of law which the decision of the Ninth Circuit addresses, it is respectully submitted that review by this Court on writ of certiorari is not warranted where the decision is entirely consistent with this Court's decisions and where any conflict with decisions of the other circuits can be reconciled.

ARGUMENT AND REASONS FOR DENYING WRIT

A. The Decision of the Ninth Circuit Did Not Sweep Away *In Pari Delicto* As a Defense and Is Not in Substantial Conflict With the Decisions of Other Circuits.

The decision of the Ninth Circuit herein did not "sweep away" the *in pari delicto* defense. Rather, it recognized the defense but held that "equal fault" within the meaning of the defense could

not exist as a matter of law if the respondents proved that they were used unknowingly as part of a scheme to manipulate the market in certain securities as alleged in their complaint.

> "In the matter before us, the complaint alleges that the fraudulent scheme was originated by the broker and his coconspirators to manipulate the market price of T.O.N.M. stock for their financial benefit. The complaint further provides that the investors acted in reliance on these representations without knowledge of the true facts. The allegations of the complaint, if proved, would demonstrate that the investors could not have been equally responsible for the injury they suffered as a result of this fraudulent scheme. Therefore, the complaint should not have been dismissed on the basis of *in pari delicto*."

Opinion, App. A-6.

It is respectfully submitted that this determination is not, as petitioner contends, in substantial conflict with

the determinations made by other circuits.

A key consideration for the Ninth Circuit in reaching its decision was this Court's decision in Ernst & Ernst. It was important for two reasons. First, this Court required a degree of scienter to establish liability in a case under the antifraud provisions of the securities laws and such scienter would be inconsistent with the notion of "equal" fault. 5/ Second, this Court implicitly approved the private action which had previously been recognized by all circuits as in accordance with the broad statutory objective of the federal securities laws. 6/

5/ See Opinion, App. A-10, n. 2.

6/ See Opinion, App. A-6.

Both Kuehnert v. Texstar Corporation, 412 F.2d 700 (5th Cir. 1969), and Malamphy v. Real-Tex Enterprises, Inc., 527 F.2d 978 (4th Cir. 1975), which petitioner contends are in conflict, were decided before Ernst & Ernst. Thus, neither decision could draw the distinction that was drawn in the Ninth Circuit decision.

Moreover, neither the Fourth Circuit nor the Fifth Circuit have concluded that in pari delicto should be a defense in a securities case without a balancing of the relative fault of the parties. 7/

7/ In Malamphy, the Fourth Circuit only concluded that it was not error to submit the defense of in pari delicto to the jury given the facts of the case. The Fifth Circuit's decision in Kuehnert has been clarified in two later cases -- James v. DuBreuil, 500 F.2d 155 (5th Cir. 1974) and Woolf v. S.D. Cohn & Co., 521 F.2d 225 (5th Cir. 1975) -- both of which

[FOOTNOTE CONT'D. ON FOLLOWING PAGE]

Silverberg v. Paine, Webber, Jackson & Curtis, Inc., 710 F.2d 678 (11th Cir. 1983), and Tarasi v. Pittsburg Nat'l Bank, 555 F.2d 1152 (3d Cir. 1977), were both decided after Ernst & Ernst. But, far from being in conflict with the decision of the Ninth Circuit herein, the decision by the Eleventh Circuit in Silverberg would appear to be completely consistent with the Ninth Circuit's conclusion that the defense of in pari delicto is inappropriate "unless the alleged facts show that the investor is equally responsible for his injury". (Opinion, App. A-11.) That is precisely what the Eleventh Circuit decided when it

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[FOOTNOTE CONT'D. FROM PREVIOUS PAGE]

adopt the standard of "clearly mutual, simultaneous and relatively equal" conduct for the defense of in pari delicto to be available.

concluded, as petitioner candidly admitted (Petition at 8), that the facts before the court did not warrant applying the in pari delicto defense. A comparison of the facts presented in Silverberg to the allegations of the respondents' complaint demonstrates that respondents did not act any more culpably than Dr. Silverberg.

The Third Circuit actually recognized that under the Ernst & Ernst decision the absence of an in pari delicto defense would have the greatest impact "on deliberate purveyors of false information", Tarasi, 555 F.2d at 1163, but ultimately adopted a rule which did not draw the distinction between deliberate

and innocent or negligent conduct. 8/ That the Ninth Circuit in its decision was willing to draw the distinction between the two types of conduct does not create the type of irreconcilable conflict between circuits which this Court need consider.

In the final analysis, there is uniformity in the approach of all the circuits to the question of the application of the in pari delicto defense. All of the courts have indicated that it is available. It is the facts of each case

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8/ The Third Circuit adopted an equal fault standard, but concluded that the conduct involved was in the nature of "equal fault" when considered in light of this Court's discussion of "passive" or "coerced" conduct in Perma Life. Tarasi, 555 F.2d at 1162. It is respectfully submitted that the conclusion of the Third Circuit that equal fault existed in Tarasi resulted more from a narrow construction of the holding of Perma Life than an actual belief that the parties were equally at fault.

which determine whether it will be applied.

B. The Ninth Circuit's Decision Is Not an Unwarranted Extension of This Court's Perma Life Holding.

Petitioner contends that the Ninth Circuit's reliance on this Court's Perma Life decision ignores crucial distinctions between the federal antitrust and securities laws and therefore was misplaced. Petition at 15-16 and 23.

The goal of preventing common law barriers to relief in a private suit which serves the important public purpose of a "bulwark" of enforcement is not different simply because the private action is specifically provided for in one regulatory scheme and judicially inferred in another. If anything, the public policy which sustains the inference of a private action for needed enforcement of the regulatory scheme would seem more likely

to compel private action enforcement which is unfettered.

The petitioner also contends that in Perma Life the conduct of the plaintiff was much less culpable than defendants. Petition at 13 and 16.

Respondents respectfully submit that although in Perma Life this Court actually found on the facts that the parties were not of "equal fault" because the plaintiffs had a weaker bargaining position and were coerced into accepting the overall contractual scheme, 392 U.S. at 139, it nevertheless held even in circumstances of equal fault an in pari delicto defense could be considered inappropriate. As Justice Black stated:

> "We have often indicated the inappropriateness of invoking broad common law barriers to relief where a private suit serves important public purposes. . . . A more fastidious regard for the relative moral

> worth of the parties would only result in seriously undermining the usefulness of the private action as a bulwark of anti-trust enforcement."

392 U.S. at 138.

Finally, the petitioner contends that the Ninth Circuit purported to apply the Perma Life policy analysis without any basis in fact. Petition at 8-9 and 23. A review of the decisions relied upon by petitioner reveals that the courts in those cases had no facts upon which to base their conclusion that the proper policy to effectuate would be to deter the taking of the tip. Yet, the SEC, which the petitioner is quick to point out is the only one charged under the Insider Trading Sanctions Act of 1984 with the responsibility for enforcement of the ban on insider trading, filed an amicus brief in the Ninth Circuit advising the court that the proper policy

to effectuate is to deter the giving of tip.

C. The Ninth Circuit Correctly Concluded That the Duped Investor Is Not Equally Culpable.

One issue presented by the petition is, what is the relative fault between a broker or corporate insider who deliberately provides a false tip in order to manipulate a securities market for his own personal gain, versus the investor who has no knowledge that he has been provided deliberately false information under the guise of a tip who attempts, out of the very weakness which the broker or insider intended to exploit, to take advantage of his good fortune in receiving the information which has been imparted to him. The petitioner contends that the investor tippee is at least equally culpable with the scheming broker or corporate insider because the investor

is the very person who directly causes the damage to the securities markets. Petition at 21. That is like saying a bullet is equally culpable with a person who pulls the trigger of a gun. There will be no takers of tips if there are no tips. The opposite is not true. And, if brokers and corporate insiders are protected by the doctrine of in pari delicto even when they disseminate deliberately false tips to manipulate the market, an abundance of such tips will always exist in the hopes that some unsuspecting investors will appear.

D. The Ninth Circuit's Decision Is Not Inconsistent With Either the Policy of the Insider Trading Sanctions Act of 1984 or the Savings Clause of the Securities and Securities Exchange Acts.

The petitioner argues that the absence of private actions under the Insider Trading Sanctions Act of 1984

implies that there is no Congressional policy to encourage duped investors to sue brokers and corporate insiders who provide fraudulent tips. But this argument misses the mark since the duped investors are not suing on an insider trading theory. They are suing under the antifraud provisions of the securities laws because they have been defrauded by an attempt to manipulate the market.

The fact that only the SEC is empowered to bring actions under the Insider Trading Sanctions Act, however, does raise the question of how brokers or corporate insiders, who are deliberately spreading false information under the guise of tips, can be identified so that the SEC may pursue the remedies of the act. In its amicus brief in the Ninth Circuit, the SEC contended that its ability to pursue such conduct in the

securities market would be advanced if duped investors had an incentive to identify the brokers and corporate insiders from whom they were receiving fraudulent tips. Certainly, there is no incentive for a duped investor to identify the source of false information if the doctrine of in pari delicto will prevent him from recovering his losses.

The petitioner also suggests that Sections 16 and 28(a) of the Securities and Securities Exchange Acts imply that the Congressional intent was to preserve the common law defenses, including in pari delicto. Petition at 10. Throughout the petition, the petitioner attempts to make distinctions based upon the absence of express language; e.g., absence of express private action under federal securities laws. Neither of the cited sections "saves" defenses.

CONCLUSION

Despite petitioner's rhetoric and hyperbole the decision of the Ninth Circuit is not a drastic departure from established law. Indeed, it follows and is supported by established law. Moreover, it reflects proper enforcement policy, a fact substantiated by the SEC.

For these reasons, respondents respectfully request that the petition for a writ of certiorari be denied.

Dated: November 29, 1984

Respectfully submitted,

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AFFIDAVIT OF SERVICE BY MAIL

State of California)
) ss.
City and County of San Francisco)

Josie Strupaitis, being first duly sworn upon oath, deposes and says:

That affiant is a citizen of the United States, over 18 years of age, and not a party to the within cause; that affiant's business address is 862 Folsom Street, San Francisco, California 94107; that affiant served three, true and correct copies of the attached **Brief In Opposition to a Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit** on the following person, by placing same in an envelope addressed as follows:

Robert S. Warren, Esq.
Gibson, Dunn & Crutcher
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that said envelope was then, on November 29, 1984, sealed and deposited in the United States Mail at San Francisco, California, with the postage thereon fully prepaid; and that there is delivery service

by United States Mail at the place so addressed, or that there is regular communication by mail between the place of mailing and the place so addressed.

Joan Stumpaitis

Subscribed and sworn to
before me this 29th day
of November, 1984

Arthur L. Martin

Notary Public in and for
the City and County of
San Francisco, State of
California

